No. 87-51 (2)

Supreme Court, U.S.
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In The
Supreme Court of the United States
October Term, 1987

MAGDALINE M. HANSEN, individually and on behalf of all those similarly situated,

Appellants,

v.

CITY OF SAN BUENAVENTURA,

Appellee.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

MOTION OF APPELLEE CITY OF SAN BUENAVENTURA TO DISMISS OR AFFIRM

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QUESTIONS PRESENTED

1. Was it unconstitutional for the California Supreme Court to uphold separate customer classifications and rates based upon differences in cost of service, contributions and risks, and the need to purchase a replacement water supply for outside-City customers?

2. Was it proper for the California Supreme Court to allow Ventura to recover a return on the investment in City facilities devoted to the use of outside-City customers?

3. Did the California Supreme Court properly determine that Ventura's rate differential was not based solely on the nonresident status of outside-City customers, and that the City had not discriminated against them?

4. Was the Court entitled to consider expert testimony and other evidence to review the reasonableness of the City's rate schedule?

PARTIES TO PROCEEDINGS BELOW

Original parties before the California Supreme Court: (1) Magdaline M. Hansen, individually and on behalf of all those similarly situated, the appellants herein; and (2) the City of San Buenaventura ("Ventura"), the appellee herein.

Amici curiae, before the California Supreme Court, by permission of the Court: the cities of Antioch, Beverly Hills, Camarillo, Chico, Covina, Del Rey Oaks, Huntington Beach, Los Angeles, Marina, Napa, Needles, Palm Springs, Riverside, Roseville, Sacramento, San Francisco, South Lake Tahoe, and Tustin.

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On Appeal from the Supreme Court of the State of California

MOTION OF APPELLEE TO DISMISS OR AFFIRM

Pursuant to Rule 16.1, appellee, the City of San Buenaventura, respectfully requests this Honorable Court to dismiss the appeal now pending on the grounds that the judgment rests on an adequate non-federal basis, and the federal questions presented are so unsubstantial as to require no further argument; or in the alternative, to affirm the decision of the California Supreme Court.

STATEMENT OF THE CASE

This appeal seeks to attack the validity of water rate ordinances enacted by the City of San Buenaventura.[1/] Specifically, appellants assert that the ordinances are unconstitutional because higher water rates were established for customers located outside the City than for those within.

The facts pertinent to this motion are accurately and fairly described in the "Appendix to Jurisdictional Statement"[2/] at pp. 1-15 (the Opinion of the California Supreme Court) and in the "Findings of Fact and Conclusions of

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1/ The initial rate ordinance establishing a 70% differential for outside-City use was adopted in 1972. The differential was confirmed by later City Councils in 1975 and 1977. (Exh. 37-39, 56)

2/ Herein described as "App."

Law"[3] of the trial court. The Opinion of the California Supreme Court[4] and the Findings, when compared to the alleged facts set forth in the Jurisdictional Statement filed by appellants, amply demonstrate that appellants are simply wrong when they state, "The facts of this case are undisputed."[5]

After nine days of trial, extensive testimony from expert witnesses, and numerous exhibits, the trial court concluded that appellants were not denied equal protection of the laws. (App. 300, 329) Appellants' claims primarily are factually based, charging the City with a deliberate attempt to treat them unfairly, and the

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3/ Herein called "Findings" (App. 231-333).

4/ Herein called "Opinion."

5/ Jurisdictional Statement (herein described as "J.S." p. 9).

trial judge decided the facts against them. (App. 261-274) The California Supreme Court agreed with the trial court. (App. 27-40)

Appellants' "Statement of Facts," however, re-argues the evidence as though this matter were still before the trial judge. (J.S. 8-24) Furthermore, they selectively use only the evidence they consider favorable to their case. Appellants wholly fail to carry out their duty to set forth the facts in the light most favorable to the judgment below.

For example, they repeatedly assert that there is ". . . no cost difference whatsoever" in providing water to customers inside and outside the City. (J.S. i-ii, v, 19, 25, 33) Yet the trial court found precisely to the contrary. Appellants' costs of service were not the same as customers

within the City; they were greater. (App. 259-63, 279-81, 283; see also, Opinion, App. 31-32) Appellants even assume there is no difference in costs when framing the first question presented by their appeal. (J.S. i-ii) And they go still further to state that the City admits that its higher outside rates are not based on cost differences. (J.S. 20) This is simply untrue. Appellants rely upon only a portion of the City's answer to an interrogatory, but the full answer clearly shows that Ventura made no such admission. (C.T. 519, 531; App. 261, 283, Exh. Q)

Appellants' legal argument also rests on the false statement, repeated often, that Ventura's water system was financed entirely from revenues from the sale of water, and so outside-City customers contributed equally to those

within. They state this as an accepted fact. (J.S. ii, 20, 21) Yet, again, the trial court specifically found otherwise. City general funds, grants, power tax revenues, and acreage and connection fees paid only by customers within the City all went to support the water system. (App. 276, C.T. 527-28, R.T. 705, 778, 887-88) Customers outside the City paid none of these, and their financial contributions were not the same as those within the City. Contrary to appellants' repeated claims (J.S. 24, 32, 38, 52), the trial court found that those customers outside the City were not "similarly situated" to those within, and the California Supreme Court agreed. (App. 264-65; see also, Opinion, App. 27-32)

In short, appellants' initial statement of the "facts" is nothing more than a review of their assertions at

trial, on disputed issues, without acknowledging that the trial court found against them, and without discussing the City's evidence in support of the findings. Appellants were not "singled out" for unjust discrimination; their rates were not based simply on their nonresident status. (App. 260-74, 297-300, 515-16) The rate surcharge was fully justified on a number of appropriate rate-making bases, including higher costs of service, the fact that the water system was supported by inside-City contributions not made by nonresidents, and the fact that nonresidents did not bear the same financial risks as those within the City.

The Court of Appeal specifically declined to rule on appellants' equal protection arguments, relying instead on what the Court viewed as common law principles. In any event, the Appellate

Court's judgment was reversed by the California Supreme Court. (App. 3)

The Supreme Court of California granted review:

> "to resolve the important question of whether a municipal utility may recover a reasonable rate of return on its investments and to clarify what circumstances may be considered by a court in determining whether a rate is reasonable." (App. 2)

The Court determined, based upon the specific facts in this case, that the classification of customers by the City and the higher outside rates were justified and reasonable. The decision is amply supported by established California law, and presents no substantial federal question for review by this Court.

I. THE JUDGMENT RESTS ON AN ADEQUATE NON-FEDERAL BASIS. NO SUBSTANTIAL FEDERAL QUESTION IS PRESENTED

Under established California law, utility customers may be classified "upon any reasonable basis," and a rate differential may rest upon "cost of service or some other reasonable basis." (Durant v. City of Beverly Hills, 39 Cal.App.2d 133, 139 [1940]; County of Inyo v. Public Utilities Com., 26 Cal.3d 154, 159 fn. 4 [1980]) Rates established by a city are presumed to be fair and reasonable, and will be upheld if supported by any conceivable state of facts. (Elliott v. City of Pacific Grove, 54 Cal.App.3d 53, 57 [1975]; Toward Utility Rate Normalization v. Public Utilities Com., 22 Cal.3d 529, 543-44 [1978]; Swanson v. Marin Mun. Water Dist., 56 Cal.App.3d 512, 523 [1976]; see also Dandridge v. Williams, 397 U.S. 471, 485; 25 L.Ed.2d 491

[1970]; McDonald v. Bd. of Election Com. of Chicago, 394 U.S. 802; 22 L.Ed.2d 739 [1969]; McGowan v. Maryland, 366 U.S. 420; 6 L.Ed.2d 393 [1961]) Appellants bear the burden of showing that the City's classification of customers and rates were unfair or unreasonable. (D'Amico v. Board of Medical Examiners, 11 Cal.3d 1, 17 [1974]; App. 16-18; McGowan v. Maryland, supra; Federal Power Com. v. Hope Nat. Gas Co., 320 U.S. 591, 602; 88 L.Ed. 333, 345 [1944])

The fundamental question in this case is whether appellants' rates and the differential were reasonable. That is the "beginning and end of the judicial inquiry." (App. 17-18) Appellants' average monthly water charge was $14.51, and they virtually conceded

that the total charge was reasonable.[6/] Their basic complaint was that they were not charged the same as customers within the City. After reviewing all of the evidence, the California Supreme Court further determined that the surcharge too was reasonable. This appeal, under the guise of an equal protection challenge, is nothing more than an effort to overturn the California Supreme Court's determination that the evidence supported the reasonableness of the rates. The Supreme Court pointed out that without the surcharge, users inside the City "would be subsidizing out-of-city rate payers . . ." (App. 34)

6/ The findings demonstrate that "plaintiffs presented no credible evidence that the rates in question were unreasonable" (App. 3[illegible]:#68). The findings show that the City submitted a number of studies which indicate the reasonableness of the rates. (App. 319:#97; 325:#125-26)

The evidence showed that in 1923 Ventura purchased its municipal water system, financing the purchase price through a general obligation bond issue. (Exh. 51-53, D, J) Between 1925 and 1960, the City authorized four additional general obligation bond issues to enlarge, improve and modernize the water system. (Exh. E-I, GG) These bonds were a lien upon all private property within the City. Property outside of the City was not subject to risk of repayment. The same was true with respect to a $58 million contract obligation with the State of California to obtain supplemental water from the State Water Project. (Exh. MM)

Throughout the years, the City also used general fund monies and other funds to help finance, operate and improve its water system. These revenues were in addition to water rates

collected from customers. City general funds were used to pay the salaries of City employees who performed accounting, billing, purchasing, legal and other administrative services for the water system, and to provide warehouse and office space for water system employees. (R.T. 967, 1015, Exh. T-Z) Numerous grant funds were secured and utilized by the City for the benefit of the water system. (R.T. 886-890) The City also made a number of substantial transfers from its general fund to the water fund either at little or no interest. (R.T. 996-1000, Exh. FF) Substantial power tax revenues were also used within the water system, representing transfers of tax payments made by City residents only. (R.T. 1003, Exh. II) In addition, new customers within the City were required to pay connection and acreage fees in order to

obtain water service. Contrary to what appellants say (J.S. 34-35), such funds were utilized for the benefit of the entire water system, and not merely to supply specific properties. (R.T. 765-66, 933, 992-1000, Exh. EE, App. 277) Customers and developers located outside of the City did not make such payments. (R.T. 933, 994-95, 1136, App. 276)

The vast majority of the City's outside customers were added in 1966 and 1969 when the City purchased the Mound and Saticoy Water Companies. Saticoy, which was the larger of the two companies, served both within and outside the City boundaries. Both companies were substandard. Their water supplies from local wells did not meet public health standards, and the City was required to abandon the wells and purchase more costly water at wholesale

in order to supply these customers. (R.T. 690, 1066, 1068-69, 1078, App. 243-251) The California Supreme Court called attention to the fact that appellants "fail to mention that the cost allocated to nonresidents covered only the cost required to supply them." (App. 35) There was expert testimony that the City's extra costs in replacing these polluted well supplies were sufficient reason alone for the price differential. (R.T. 1080-81)

The Mound and Saticoy systems were also deficient in storage facilities. Connection to the City system gave these new customers substantial and immediate benefits: better fire protection, and needed system reliability by virtue of the capacity made available in the City's existing storage tanks, treatment plants, pumping stations and major transmission lines. (Exh. R, pp. 25-26;

R.T. 1081-83; C.T. 514-16; App. 253-57) But such benefits also used up reserve capacity inside the City, and the trial court found that such benefits "have corresponding costs to inside residents and customers." (C.T. 529, App. 279, 280) If the City had been required to build these facilities, such costs would have been taken into account in setting outside rates. The court concluded:

> "The fact that some of such facilities had already been constructed by the City, for the benefit of their own future growth, does not make them of less value to the outside customers, or of less cost to the City users." (C.T. 548; App. 314)

At the trial, there was also expert testimony based on the "utility method" of analyzing rates. The utility method is a cost of service analysis widely used throughout the nation.

(R.T. 732-34; App. 278-86)[7/] It provided for a rate of return to the City based upon those City facilities that were devoted to the use of the outside-City customers. The California Supreme Court found that using a rate of return concept would be appropriate, stating that such a rate of return was, "in essence, payment for the use of property of another." (App. 23) Using the utility method, a differential of 98.5% would have been reasonable under the facts in this case. (R.T. 831-36; Exh. S; App. 15, 312) The California Supreme Court noted that, "nonetheless, Ventura continued to impose the 70

7/ This method of utility rate-making is recommended by the American Water Works Association. Furthermore, the method had been previously utilized and approved by the predecessor to the present California Public Utilities Commission in reviewing outside-City rates. (App. 242-43, 278-79, Exhs. K and L)

percent surcharge it had established in 1972." (App. 21)

The trial court found, based upon extensive evidence, and the California Supreme Court affirmed, that customers outside of the City had not made the same contributions to the water system as those within, that they did not bear the same risks, and that increased costs of service were present. In short, appellants were not similarly situated to customers within the City, and a reasonable basis existed for classifying them separately and charging the higher rates. Whether a difference in rates is justified, or constitutes unjust discrimination, is a question of fact, not law. (City & County of San Francisco v. Western Air Lines, Inc., 204 Cal.App.2d 105, 137 [1962]; Bowers v. Bernards, 150 Cal.App.3d 870, 873 [1984]; California Public Utilities Code, §1757; Alabama

Pub. Serv. Com. v. Southern R. Co., 341 U.S. 341; 95 L.Ed. 1002 [1951]; Barringer & Co. v. United States, 319 U.S. 1; 87 L.Ed. 1171 [1943])

II. STANDARD OF REVIEW UNDER THE EQUAL PROTECTION DOCTRINE

In seeking review of their equal protection claims, appellants argue that nonresidents are a "suspect class; therefore the "strict scrutiny" test should be applied. Appellants' stated reason is that they are politically powerless, but no case supports this legal position. The California Supreme Court declined to extend the suspect class analysis, stating:

> "We have categorized only a few classifications as suspect, namely classifications involving race, alienage, or national origin." (App. 46-47)

California conforms to the most recent statement of the rule by the United States Supreme Court:

> "The general rule is that legislation is presumed to be valid and will be sustained if the classification drawn by the statute is rationally related to a legitimate state interest. . . . When social or economic legislation is at issue, the Equal Protection Clause allows the states wide latitude, . . . and the Constitution presumes that even improvident decisions will eventually be rectified by the democratic processes.
>
> The general rule gives way, however, when a statute classifies by race, alienage or national origin. These factors are so seldom relevant to the achievement of any legitimate state interest that laws grounded in such considerations are deemed to reflect prejudice and antipathy -- a view that those in the burdened class are not as worthy or deserving as others. For these reasons and because such discrimination is unlikely to be soon rectified by legislative means, these laws are subject to strict scrutiny and will be sustained only if they are suitably tailored to serve a

> compelling state interest. . . .
>
> Legislative classifications based on gender also call for a heightened standard of review. That factor generally provides no sensible ground for different treatment . . . Because illegitimacy is beyond the individual's control and bears 'no relation to the individual's ability to participate in and contribute to society, '. . . official discriminations resting on that characteristic are also subject to somewhat heightened review." (Cleburne v. Cleburne Living Center, 473 U.S. 432; 87 L.Ed.2d 313, 320-21 [1985])

The State's concern that rates be fair and efficient represents a clear and substantial governmental interest. (Central Hudson Gas v. Public Service Comm'n, 447 U.S. 557, 569; 65 L.Ed.2d 341 [1980])

Where social or economic regulations are involved, the so-called "rational basis" standard of review applies. (Minnesota v. Clover Leaf

Creamery Co., 449 U.S. 456; 66 L.Ed.2d 659 [1981]; Schad v. Mt. Ephraim, 452 U.S. 61, 68; 68 L.Ed.2d 671 [1981]; U.S. Railroad Retirement Bd. v. Fritz, 449 U.S. 166, 176; 66 L.Ed.2d 368 [1980]; New Orleans v. Dukes, 472 U.S. 297; 49 L.Ed.2d 511 [1976]; Dandridge v. Williams, 397 U.S. 471, 485; 25 L.Ed.2d 491 [1970]) Water rates are economic regulations subject to review under the rational basis test. (Toward Utility Rate Normalization v. Public Utilities Com., 22 Cal.3d 529 [1978]; Kennedy v. City of Ukiah, 69 Cal.App.3d 545 [1977]; Swanson v. Marin Mun. Water Dist., 56 Cal.App.3d 512 [1976]) Under the traditional rational basis test, there is a presumption of constitutionality, and the court requires only that the distinctions drawn in the challenged statute bear some rational relationship to a conceivable legitimate state

purpose. (Fullerton Joint Union High School Dist. v. State Bd. of Education, 32 Cal.3d 779 [1982]; Curtis v. Board of Supervisors, 7 Cal.3d 942 [1972]; In Re Antazo, 3 Cal.3d 100 [1970]; New Orleans v. Dukes, 472 U.S. 297; 49 L.Ed.2d 511 [1976])

The United States Supreme Court has ruled that nonresidency is not sufficient to invoke the strict scrutiny test. (Holt Civic Club v. Tuscaloosa, 439 U.S. 60; 58 L.Ed.2d 292; 99 S.Ct. 383 [1978]) Indeed, appellants' inability to vote in City elections does not equate to political powerlessness. As a practical matter, most utility rate decisions turn upon rate hearings, not upon councilmatic elections. At the very rate hearing in question, appellants were represented by a distinguished member of the county board of supervisors. (Exh. 40)

Political influence at the local level can be exerted, and often is, in many ways -- lobbying, petitions, testimony at hearings, political contributions, and letters to the editor, among others. Moreover, viewed from a statewide perspective, nonresident customers have equal power to seek legislation governing rate-setting by municipalities, and the potential power to elect representatives who will seek such legislation. Appellants are no more politically powerless as customers of a municipal water system than they were as Mound and Saticoy customers.

Finally, the California Supreme Court noted that the reasonableness test applied to municipal rates "is somewhat more stringent than the bare rational-basis test." (Opinion, App. 48-49) It concluded:

> "Ventura has met the reasonableness standard; a

fortiori, it passes the rational-relationship test." (Opinion, App. 49)[8/]

III. APPELLANTS WERE NOT "SINGLED OUT" FOR UNREASONABLE DISCRIMINATION

The dominant thrust of appellants' equal protection challenge is the claim that nonresident customers were singled out for unjust discrimination solely on the basis of their nonresident status. (J.S. i, 5-6, 52, 55) They rely heavily upon early correspondence between the City's Public Works Director and the City's rate consultant, Wilsey & Ham. Appellants charge that the City directed the consultant to omit revenues from certain oil company customers in order to justify a preordained 70% sur-

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8/ It is worthy of note, in addition, that the trial court specifically found that "no matter what standard of review is used it has been fully demonstrated that the customer classes and rates in question are reasonable." (App. 328)

charge. (J.S. 12-15, 42, 45-46) In essence, appellants sought to prove that the Ventura City Council in 1972 acted in bad faith, and deliberately attempted to profit from them.

Once again, appellants attempt to put this Court into a fact-finding role. And again, their evidentiary allegations are directly contrary to the trial court Findings, confirmed by the California Supreme Court. The trial court specifically rejected the contention that the City had ". . . deliberately sought to impose or enact an unjust water rate, or arbitrarily and unjustly sought to classify its various water customers . . ." (App. 260)

Appellants seek to color the issue further by saying the nonresident customers were "swept" and "pulled" into the system "involuntarily." (J.S. 24, 34 fn. 15, 36) The fact is that the

Mound customers were also shareholders in the company and had to approve the transfer to the City; and the Saticoy acquisition was approved by the California Public Utilities Commission without protest from any Saticoy customers. (App. 6, 9, 244-45, 247)

The evidence at trial showed that early in the rate study, the City's consultant recommended a surcharge of 38.8%. However, this conclusion was based on data that had not been properly segregated and identified. As the consultant learned later, the City had supplied him with revenue figures not only from the domestic customers, but also from a separate class of industrial untreated water customers. These industrial customers (oil companies) received nonpotable water for secondary recovery purposes. Such water was unfit for domestic use, and was not supplied

through the domestic water system. These untreated water customers had been treated as a separate class with separate rates since 1923. Upon learning of this mistake, the consultant revised his study so as to consider only those revenues and expenses related to the domestic water supply system. The result was a 70% surcharge recommendation. (App. 14-15, 39-40, 289-93; R.T. 519-28, 532-53) Appellants tried throughout the trial to imply that this change was made merely to profit from the outside-City domestic water customers. But the consultant was a witness at the trial, was cross-examined, and the court found against appellants.

Perhaps, however, the most succinct answer concerning the exclusion of oil company revenues came from appellants' own expert witness at the

trial. He agreed that the untreated water customers comprised a separate class, and that their revenues and expenses should not be included in studies to determine domestic water rates. (R.T. 366-67; App. 288)

The City Council's action to increase the existing 32% surcharge to 70% did not occur until 16 months after the consultant's report. (Exh. 39, Exh. 35, C.T. 517; App. 257-58) This was also three years after the Saticoy acquisition and six years after the Mound agreement. Certainly the timing would not indicate that the City was bent upon trying to profit from its outside customers.

At the time the rate ordinance was adopted, the City had already replaced the polluted Mound and Saticoy water supplies, and had undertaken a major water construction program, in part to

supply the outside-City customers. (R.T. 690, 992-99) At the rate hearing, the City manager stated that it was not the City's intention to "make money on a vital public service," but rather the surcharge was a "method of directly eliminating subsidy of outside water users." (J.S. 16, 17) No revenues from the City's water system went into the City's general fund. All revenues were put back into the water system. (R.T. 161, 340, 345; App. 294)

A. The Validity Of The Ventura Rate Ordinances Are Not To Be Determined On The Basis Of Appellants' Claimed "Actual And Articulated Purposes"

Appellants' equal protection challenge also rests upon the legal premise that the City is bound by the "actual and articulated purpose" for which the surcharge was imposed. (J.S. vii, 42) Appellants allege that the

true purpose of the 1972 rate ordinance was to recover "fictitious subsidies," and that the validity of the ordinance cannot be supported by "after-conceived justifications." (J.S. 46-47)

Their argument assumes, to begin with, that some kind of legislative record is available on which motivation can and should be judged. This is not true. Rate-making is a legislative act. (San Diego Land & Town Co. v. National City, 174 U.S. 739; 43 L.Ed. 1154 [1899]; American Microsystems, Inc. v. City of Santa Clara, 137 Cal.App.3d 1037 [1982]) Legislative action does not require hearings or an evidentiary record. (Bi-Metallic Invest. Co. v. State Bd. of Equalization, 239 U.S. 441, 445; 60 L.Ed. 372, 375 [1915]; McKinny v. Board of Trustees, 31 Cal.3d 79, 98-99 [1982]; Horn v. County of Ventura, 24 Cal.3d 605, 612 [1979])

When reviewing a legislative act, the law is clear that it is the result that counts, not the motivation of the legislative body, nor what the legislative body may have considered. (Federal Power Com. v. Hope Nat. Gas Co., 320 U.S. 591, 602; 88 L.Ed. 333, 345 [1944]) Appellants argue that in 1972 the City Council had before it and relied only upon the original Wilsey & Ham report, that the report was part of a deliberate scheme to overcharge nonresidents, and that the report contained certain admittedly improper factors in justifying the surcharge.[9] In essence, appellants assert that it was improper for the trial court to receive expert testimony and other

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[9] The trial court explicitly stated, "I don't know whether the City Council, 17 or 18 months after the Wilsey-Ham report, relied on each of those things or not. I don't know what they thought." (R.T. 373)

evidence, beyond the Wilsey & Ham report, that justified the reasonableness of the ordinance. This is not the law. The court's review of a city council's legislative act is not confined to what the members may have considered, but will be determined on the basis of all the evidence at the trial, including "expert testimony presented by the parties." (County of Inyo v. Public Utilities Com., 26 Cal.3d 154, 159-60 [1980]; Wisconsin v. Federal Power Comm., 373 U.S. 294, 309; 10 L.Ed.2d 357, 368 [1963]; Spring Valley Water Works v. San Francisco, 124 F. 574, 584-85 [C.C.N.D. Cal. 1903])

Appellants also ignore the fact that this case involves three separate council actions in 1972, 1975 and 1977, with different council memberships acting on each, and that a subsequent rate study by Brown & Caldwell,

following nationally recognized principles, indicated that the 1972 rates actually charged to outside-City customers were insufficient by $80,200 to cover their share of costs, and that a differential of 98.5% would have been justified. (App. 312; see also Opinion, App. 15, 21) Furthermore, the evidence showed that the improper factors considered in the Wilsey & Ham report affected the surcharge by only 2.9%, and that all of the data still supported the 70% recommendation. (R.T. 552-53; App. 96-97)

In the last analysis, the overriding fact is that all the claims of deliberate discrimination were judged by both the trial court and the California Supreme Court to be without merit.[10/]

10/ At the trial, appellants attempted to show the basis for the outside rate by offering testimony from a person in the audience (a member of the County Board of Supervi-
(Continued) .

IV. THE CITY OF VENTURA IS ENTITLED TO A RATE OF RETURN ON THE FACILITIES DEVOTED TO THE USE OF OUTSIDE-CITY CUSTOMERS

Appellants argue finally that it is a denial of equal protection for the City to charge a profit, or a return on investment, from its nonresident customers without making the same charge against its resident customers, "since both classes are similarly situated in every context relevant to the Water System." (J.S. 51-52) Of course, the premise of this argument, namely, that

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sors) when the 1972 ordinance was adopted. This testimony was first allowed over the objection of the City, but eventually was stricken. Nonetheless, appellants at the trial continued to attack the motives of the 1972 City Council. So much so, the City finally brought five members of that City Council into court, prepared to testify. At that point, appellants objected to such rebuttal testimony, and the issue was withdrawn from the case. All testimony of the Council's original intent and reliance was stricken from the record. (R.T. 950-65)

both classes are similarly situated, has been specifically rejected in the Findings. (App. 264-65) That could be a complete reply. However, rate of return was a major issue during the trial and before the Court of Appeal, and perhaps warrants additional discussion.

Indeed, it was the rate of return issue that principally caused the California Supreme Court to hear the case. The Court of Appeal had determined that allowing any rate of return was the equivalent of "profit," and was unlawful. This was a startling conclusion, unsupported by prior law, and with far-reaching policy implications. The policy importance of the question was aptly underscored by the appearance of Amici Curiae in the California Supreme Court on behalf of 19

cities, including San Francisco, Los Angeles, Fresno and Sacramento.

Much of the Supreme Court's Opinion is devoted therefore to a comprehensive historical review of municipal rate-making authority. The Court concludes that municipalities clearly have the authority to earn a return on their investment in utility plant. This is true even though such return may be considered "profit." It should be understood, however, that this case was tried on a more limited basis. The rate of return concept was not employed as a way to make a profit for the City. Ventura did not make transfers from its water system into the City general fund. Rather, rate of return merely comprised part of a "cost of service" analysis used by the City experts (App. 278-86, 312-13), and was but one of several bases used to

demonstrate the reasonableness of the rate ordinances.

A composite rate of return of 8.67% was utilized in determining the appropriate surcharge for outside-City customers. The California Supreme Court stated that this rate of return "was much lower than that granted a number of companies regulated by the California P.U.C." (App. 21) The composite rate consisted of three components: (1) an amount necessary to provide for adequate depreciation; (2) an amount required to pay interest on debt; and (3) a charge for the use of facilities serving the outside customers, based upon the City's paid-up equity in those facilities. This rate of return was viewed by the experts and the trial court as an "economic cost," and not as a profit. (R.T. 300, 763, 919-20, Exh. R, p. 25, C.T. 530; App. 282) Customers inside

the City were charged a 2.8% rate of return, which included only depreciation and debt requirements. (Exh. R, p. 7) The difference between the two rates of return reflects the fact that City residents were not charged for the use of their own property.

Appellants argue that as rate-payers they provided the investment, and therefore the City should not be allowed to collect a return on capital they contributed. (J.S. 50) They say the City is "extracting a profit only from nonresidents," and this demonstrates the clearest case of discrimination resting solely on nonresident status. (J.S. 52) But, again, appellants are factually wrong. The vast majority of the outside-City customers were added in 1969, and had not helped to pay for the Ventura water system. The trial court

specifically found that the former Mound and Saticoy customers were supplied from

> "sources and facilities for which they have not paid a proportionate share of the total expenses, both prior to adoption of the ordinance in question and since." (C.T. 515; App. 254)

The rate of return utilized in the utility method of analysis simply required that outside customers pay for the use of existing City facilities devoted to their use. Those facilities were no longer available to the City to serve its own inhabitants, and had not been paid for by appellants.

As a policy matter, the California Supreme Court pointed out that cities would no longer provide service outside their boundaries if they could not charge for the use of their facilities. This would discourage cities from improving service to outlying areas, as occurred here. If the Mound and Saticoy

companies themselves had improved their water supply and system facilities as Ventura did for them, these costs would certainly have been reflected in appellants' rates. To refuse to allow Ventura to recover those same costs would result in a subsidy to the outside-City customers. Municipal rates to nonresident customers must always be reasonable, and the paucity of cases in California indicates that cities have not taken unfair advantage of nonresident customers.

V. CONCLUSION

For the foregoing reasons, the appeal docketed by the appellants should be dismissed for lack of a substantial federal question and because the judgment rests on an adequate non-federal basis, or in the alternative,

this Court should affirm the decision of the California Supreme Court.

DATED: August 31, 1987

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